





# 1. The global economy

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# 1.1 Headline inflation continued to decline in 2023, while underlying inflation only peaked this year, and both remained high by historical standards

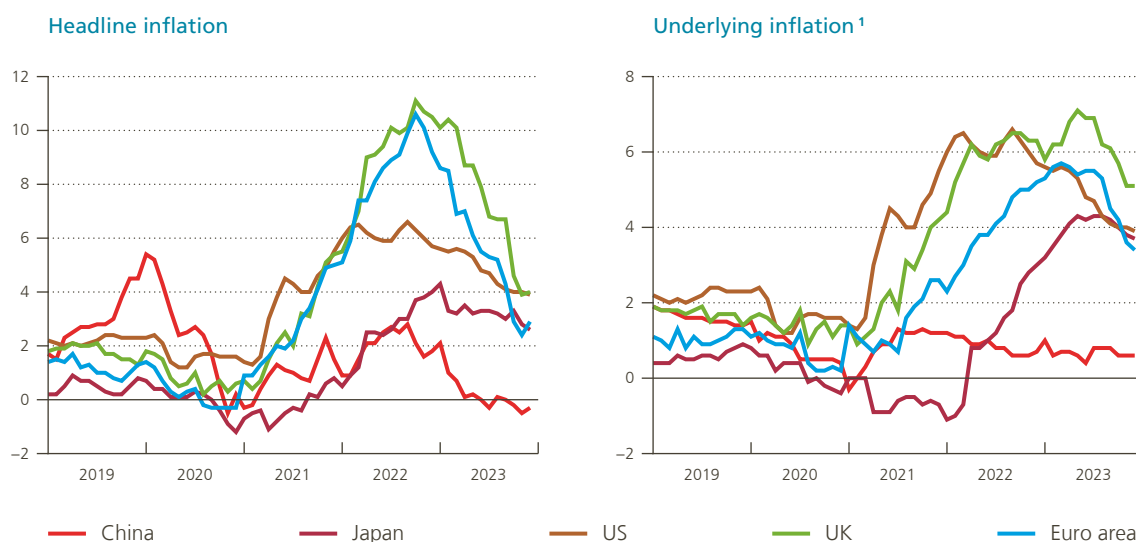
After three very turbulent years, punctuated by sizeable shocks which drew differing responses from governments, the major economies entered calmer waters in 2023. While the Covid-19 pandemic is of course not entirely over, the disease is now endemic and scarcely impacting economic activity. Russia's invasion of Ukraine and the war in Gaza have unquestionably caused tragic human losses but,

from an economic standpoint, the world did not suffer a major shock in 2023. Nevertheless, there is still a great deal of uncertainty, due in part to the policy choices that need to be made. How will authorities deal with structural challenges such as digitalisation (and artificial intelligence), climate policy and the energy transition, and what upheavals could these challenges cause in the balance of economic power?

Figure 1.1

Headline inflation fell steadily this year, while underlying inflation only peaked in the course of the year

(percentage, annual growth)



Sources: Eurostat, LSEG.

<sup>1</sup> Underlying inflation is defined as follows: Japan: all components excluding fresh food and energy; US and China: all components excluding food and energy; UK and the euro area: all components excluding food, energy, alcohol and tobacco.



**In all major advanced economies, headline inflation slowed considerably this year, but remained high by historical standards.** Aside from Japan, where the headline inflation rate did not peak until January 2023, inflation rates in the major economies continued the downward trajectory that had already begun at the end of 2022. In the euro area, the annualised inflation rate was 5.4 % in 2023, while in the US it was 4.1 %. In Japan, inflation rates remained much lower than in other advanced economies, with a year-on-year headline inflation rate of 3.2 % for 2023. Nevertheless, even in Japan, price rises hit their highest level in 32 years at the start of the year, or since the early 1980s if periods in which VAT rates were raised are disregarded. In historical terms, inflation also remained high in other major economies. Annual rates remained well above the targets set by the central banks of the United States, the euro area and the United Kingdom, despite unprecedented monetary policy tightening (see section 1.2). The exception was China, where a property sector crisis and other structural economic problems eroded consumer confidence after the economy reopened at the end of 2022 (see section 1.5). Inflation plummeted there, averaging just 0.2 % year-on-year in 2023, well below the target of around 3 % set by China's State Council.

**Inflation rates in euro area countries continued to diverge, albeit less markedly than the year before, while remaining much higher overall than before the pandemic.** There were a number of reasons for these inflation differences: administrative factors (e.g. differences in the scale and timing of the phase-out of support measures adopted in response to the 2022 energy crisis); spillover and base effects; differences in the composition of reference baskets of goods and services (causing food inflation, for example, to have a greater weight in some countries); differences in how each country's economy is structured; and divergences between business cycles and income growth.

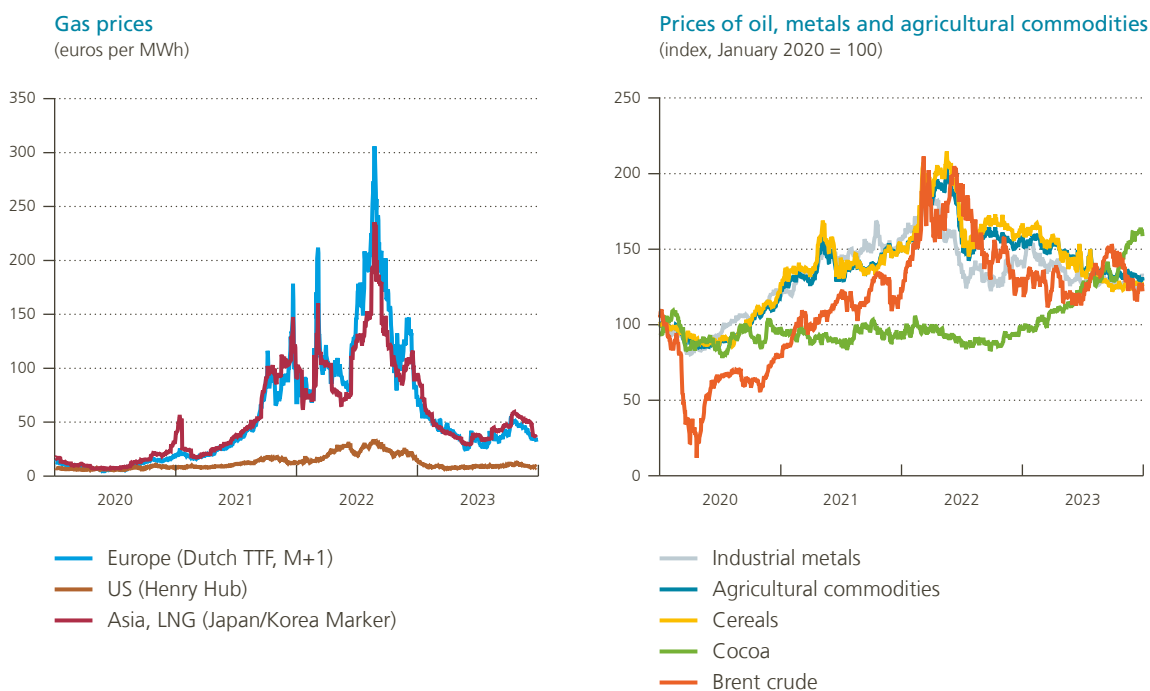
**In 2023, while internal factors and food inflation fed price growth, headline inflation was reined in by the fall in energy prices, the tightening of monetary policy and less robust demand.** Russia's invasion of Ukraine triggered an acute crisis on the energy and commodities markets as from February 2022. In addition to the substantial reduction in gas supplies from Russia, the race to build up European gas stocks sufficiently before

the winter also played a role in the huge jump in gas prices and, subsequently, electricity prices. However, robust policy responses from the EU and several heavily affected countries, together with a slight decline in energy consumption, significantly scaled back the higher energy prices towards the beginning of 2023 (see Figure 1.2). Nevertheless, oil and gas prices remained significantly higher than before the pandemic. Structurally higher gas prices in Europe, especially compared with the US, risk undermining Europe's cost-competitiveness, particularly in energy-intensive industries (see chapter 6). The sharp fall in energy prices after the peak in mid-2022 led to strongly negative annual growth in energy prices which exerted downward pressure on headline inflation rates for much of the year. Following the attacks carried out by Hamas on 7 October and the subsequent Israeli response in the Gaza Strip, nervousness briefly intensified on the oil markets. Overall, the impact remained limited in 2023, and oil prices quickly stabilised, ending the year at around the same level as at the start

of 2023. The pandemic-related disruptions to global value chains, which affected supply and hence prices until 2022, largely dissipated in 2023. This explains why the United States, which had suffered heavily from these logistics problems but had been less impacted by the hike in energy prices, was the first major economy to see headline inflation reach an inflection point once these supply disruptions had been resolved and the post-pandemic rebound in demand had peaked. Towards the end of the year, the conflict in the Middle East was having repercussions for commercial shipping and trade: as of mid-December, most of the major shipping companies decided not to transit through the Red Sea after several attacks by Houthi rebels. Given that 12 % of overseas trade in goods (and around 30 % of global container volume) is normally transported via this route, and that shipping costs are rising sharply due to higher insurance premiums and/or the rerouting of vessels around the southern tip of Africa (not to mention delivery delays), consumer prices could be affected.

Figure 1.2

**Energy and commodity prices are falling, but structural factors are keeping them above pre-pandemic levels**



Sources: ECB, Bloomberg, LSEG.

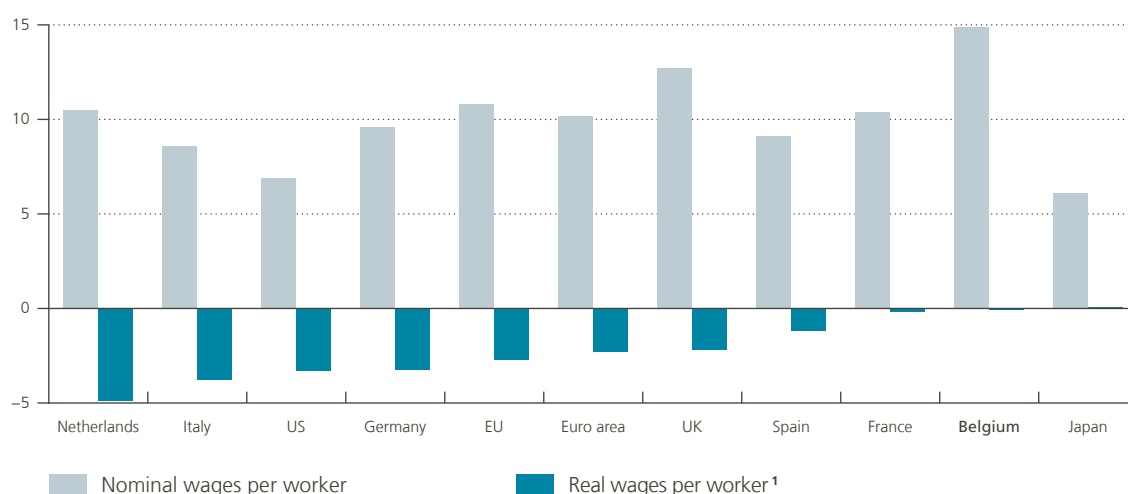
The continuing rise in food prices, although much less pronounced than last year, is due to a number of factors, mainly extreme and unusual weather conditions, which have had a major impact on harvests in several locations, but also wage growth and the fallout from Russia's invasion of Ukraine. The most oft-cited example during the year was the global price of olive oil, which hit an all-time high in December. The main cause of this surge was a severe drought brought on by heat waves in Spain, the world's leading olive oil producer, while a bacterium affected millions of trees already weakened by heat in Italy. In 2023, cocoa prices also reached a global peak due to exceptionally wet weather conditions that damaged crops in West Africa. In contrast, the prices of other agricultural commodities and several cereals fell over the course of the year. Shrinking demand, the resolution of supply issues and a slowdown in the manufacturing and construction sectors (see section 1.4) also caused the prices of industrial metals to weaken slightly. However, they remained structurally higher than prior to the pandemic, partly due to increased demand for metals as a result of more ambitious climate and industrial policies (see Box 1).

Nominal wage growth per worker tracked the rise in the cost of living, albeit with somewhat of a lag. However, the robust growth witnessed so far does not appear to have triggered a wage-price spiral. Such a phenomenon occurs when wage costs ramp up as a result of a surge in inflation and are then reflected in prices, with this price rise leading in turn to higher wage demands, and so on. Based on current figures, this does not appear to be the case at present: in most countries, real wages have fallen or stabilised since the start of 2021. Nominal wages did admittedly make up ground this year, but they still trail inflation. This took place against the backdrop of very resilient labour markets, both within and outside the euro area. In Belgium, real wage growth in 2023 almost entirely offset the decline in 2022, mainly due to the country's automatic wage indexation mechanisms, pursuant to which nominal wage growth quickly and almost fully reflects a rise in the cost of living. The rise in nominal wages did not translate into sustained inflation or higher inflation expectations. On the contrary, as previously indicated, the growth rates of both headline and underlying inflation fell over the course of the year.

Figure 1.3

### Real wages declined in most countries between 2021 and 2023

(cumulative percentage growth, 2021-2023)



Source: EC.

<sup>1</sup> Real wages per worker were deflated by the private consumption deflator.

**Underlying inflation, which excludes the generally more volatile prices of energy and food, also began to slow in 2023, in the aftermath of the deceleration in headline inflation, albeit at a gentler and less pronounced pace.** In the United States, headline and underlying inflation did peak simultaneously. US producers experienced much less price pressure from higher production costs as a result of high energy prices. Labour market tensions eased somewhat in the United States in 2023, although labour demand remained high. In the UK, the euro area and Japan, the transmission of higher food and energy prices to other prices in the economy, on the one hand, and a continually tight labour market, on the other, were the main reasons for the persistence of high underlying inflation. Inflation in the services sector, in particular, remained relatively persistent and put upward pressure on underlying inflation. However, a turning point appears to have been reached in all major economic blocs, even with respect to underlying inflation. The significant tightening of monetary policy (see section 1.2 and chapter 2), the pass-through of the fall in energy prices to consumer prices, the easing of supply constraints and the general slump in demand for goods and services are all explanatory factors.



## 1.2 Central banks stopped raising interest rates

**With inflation remaining well above target in advanced economies, the central banks of most of these countries continued to tighten their monetary policy in 2023.** After more than ten years of accommodative monetary policy, central banks kept up the momentum of accelerated normalisation which began in 2022. The post-Covid-19 economic recovery and Russia's invasion of Ukraine led to persistently high inflation rates. Faced with this situation, central banks stepped up monetary policy tightening to prevent second-round effects and avoid a de-anchoring of inflation expectations, capable of unleashing a self-fulfilling prophecy.

**Although not all central banks in advanced economies began to tighten their monetary policy at the same time, most stopped raising interest rates around mid-2023.** Differences in the origin, severity and persistence of inflation between countries led to variations in when this process was set in motion and its pace. From mid-2023, as inflation continued to decline and inflation forecasts gradually aligned with targets, the ending of the cycle of monetary policy tightening was begun, with easing envisaged in 2024.

**The Bank of England, alone among central banks, adopted a particularly proactive approach to the sale of bonds purchased during the era of quantitative easing to support the economy.** At its meeting in September 2022, the Bank of England agreed to reduce its stock of gilts by £80 billion over the next twelve months. The reduction was subsequently postponed for one month following the delivery of a "mini-budget" by the UK government and the ensuing high volatility on the markets. The sell-off continued into 2023, with the announcement in September of a further round to reduce the balance sheet by £100 billion over the period running

from October 2023 to September 2024, with the aim of reaching a balance sheet total of £658 billion. At the same time, the Bank of England raised its key rate five times during the year, taking it from 3.5% to 5.25% in August 2023. It remained at this level up to the time of writing.

**The Federal Reserve maintained its policy of monetary tightening.** Assets on the Federal Reserve's balance sheet reached an all-time high of \$ 8.96 trillion in the spring of 2022, equivalent to 36% of GDP. In June 2022, the US central bank began to reduce the size of its balance sheet by ceasing the full reinvestment of maturing Treasury securities and agency mortgage-backed securities (MBS). At the end of December 2023, its balance sheet stood at around \$ 7.7 trillion (29% of GDP). Several Federal Reserve governors have suggested that it is unlikely that this process of shrinking the balance sheet will end soon. Over the course of 2023, the Federal Reserve raised its key rate by 25 basis points four times, bringing the federal funds target range to 5.25%-5.5% in July 2023. With price pressures steadily easing in the United States, the central bank has probably reached the end of its cycle of interest rate hikes.

**Although the ECB continued its process of monetary policy tightening, it is steadily reducing its balance sheet in a more passive manner.** In December 2022, the ECB announced that, starting in March 2023, the asset purchase programme (APP) portfolio would be reduced at a measured and predictable pace by not reinvesting principal repayments on maturing securities in full. In July 2023, it put an end to such reinvestment altogether. However, the central bank did not fundamentally alter its approach to the Pandemic Emergency Purchase Programme (PEPP) in 2023, with repayments to be at least partially reinvested until the end of 2024 at the earliest. Given

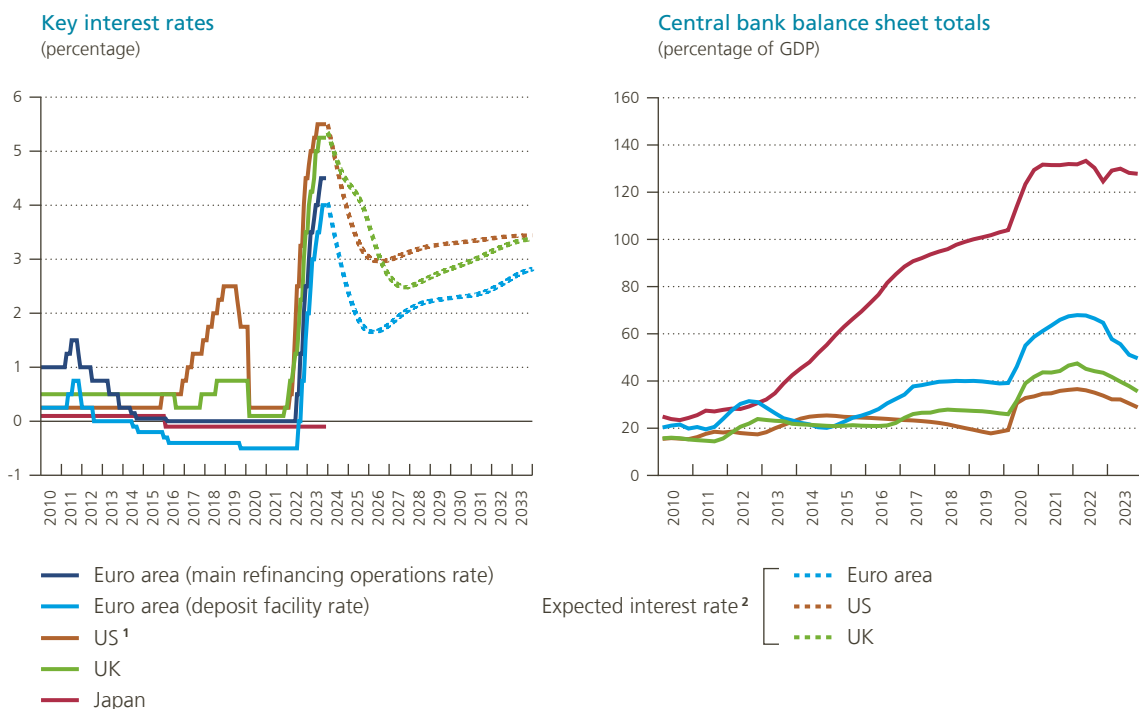
that it had begun raising its key rates slightly later than other central banks, the ECB increased them more sharply in 2023, raising the deposit facility rate from 1.5% to 4% (for more information, see chapter 2).

**The Bank of Japan endeavoured to keep its policy as accommodative as possible, while allowing for adjustments in response to market pressures.** Given the more moderate inflationary pressures in Japan, the Bank of Japan kept its key rate negative, at -0.1%. After surprising the markets in December 2022 by allowing yields on ten-year Japanese government bonds to fluctuate, the central bank once again made a significant change in October 2023. It modified its 1% limit on these yields, abandoning a strict ceiling in favour of a “benchmark” around which it will purchase long-term assets in a more flexible and reactive manner. The central bank said it was taking a slow and cautious approach to the normalisation of its ultra-accommodative monetary policy.

**The majority of emerging market economies halted their cycle of monetary policy tightening, with the exception of China, Turkey and Russia.** The Bank of Mexico and the Central Bank of Brazil were among the first to begin the process of tightening, in March 2021, and ended it in May 2022 and September 2022, respectively. In August 2023, the Central Bank of Brazil began a process of monetary easing, a decision based on the progress it had made with respect to inflation and monetary reforms. The People’s Bank of China, in the meantime, cut its key rates in June and August 2023 in order to stimulate the economic recovery and in view of the fact that its average inflation rate was well below target. However, with economic indicators pointing to a stabilisation, it kept its key rates unchanged up to the time of writing. After maintaining its stance against monetary policy tightening in 2022, despite double-digit inflation, the Central Bank of the Republic of Turkey finally began an “aggressive” tightening cycle in July 2023, raising its key rate to 42.5% in

Figure 1.4

**Central banks in most advanced economies continued to tighten monetary policy to counter stubbornly high inflation**



Sources: Eurostat, LSEG, OECD.

1 Upper bound of the target range.

2 Rate expectations at the end of December.

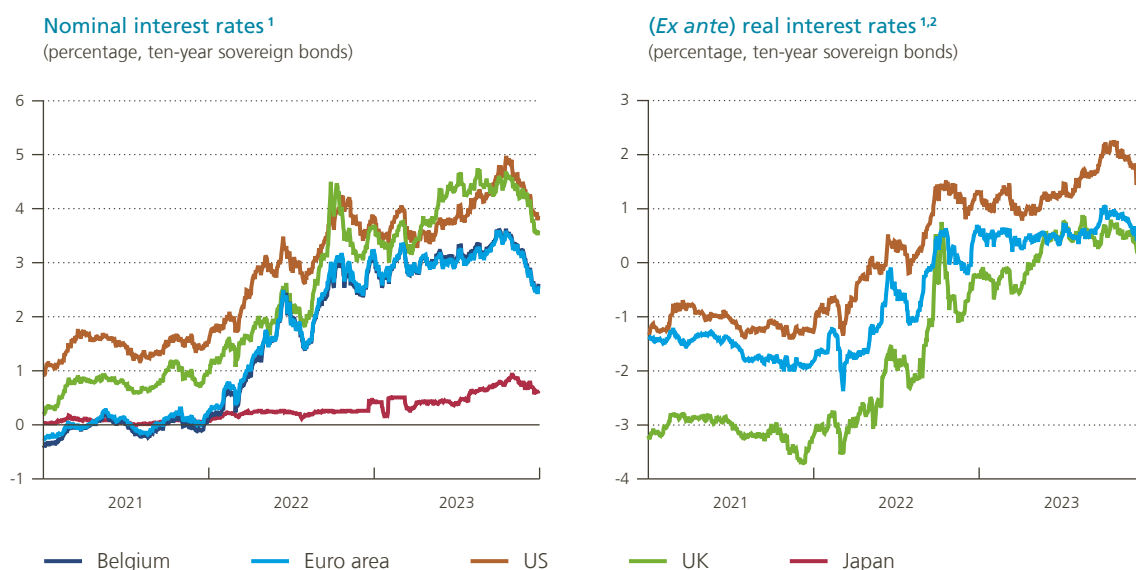
December. In Russia, the central bank hiked rates several times in a bid to combat inflation and stem the decline in the rouble.

**Ongoing monetary policy tightening in advanced economies pushed up sovereign bond yields in the first three quarters of the year, but the slowdown in inflation and inflation expectations reversed the trend towards the end of the year.** Continued key rate hikes by central banks in advanced economies led to a rise in sovereign bond yields. During the first two quarters of 2023, the rise in long-term interest rates stagnated. However, from May onwards, they began to creep up, accelerating over the summer, particularly in the United States and the United Kingdom. This was due to the bond market's expectation of no imminent monetary easing by either the Federal Reserve or the Bank of England. However, this uptick reversed in the fourth quarter as inflation expectations converged towards target rates. Sovereign bond yield volatility nevertheless remained high throughout the year, reflecting the uncertainty surrounding inflation – despite the latter dipping towards the end of the year – growth forecasts and the implications of monetary policy. In

the euro area, interest rate differentials between the southern member countries and Germany remained limited in 2023, despite turbulence in the banking sector. The Transmission Protection Instrument (TPI) and the flexibility offered by the PEPP could explain this limited fragmentation. The anchoring of long-term inflation expectations led to an *ex ante* rise in real interest rates in the US, the euro area and the UK. However, they remained only slightly above zero in advanced economies, with the exception of the United States where the real interest rate was close to 1.5% at the end of the year.

**Bond yields fell in several emerging markets, while corporate bond spreads tightened globally.** Sovereign bond yields in emerging markets, particularly Brazil, fell, mirroring expectations of lower rates. Differences in monetary policy between the United States and China, as well as the sharp appreciation of the dollar, continued to lead to significant capital flight by non-residents from the Chinese bond market. Corporate bonds, meanwhile, saw a worldwide rise in yields from April 2023, in line with risk-free rates. However, spreads narrowed, especially in high-yield segments such as technology and consumer cyclicals.

**Figure 1.5**  
**Tighter monetary policy pushed up sovereign bond yields**



Sources: Eurostat, LSEG.

1 The aggregate for the euro area is the GDP-weighted average.

2 Ten-year nominal interest rates less expected inflation, derived from swap contracts hedging inflation risk for a ten-year period.

**As a result of rising mortgage rates, borrowers faced higher repayment costs, leading to a slowdown in housing activity and falls in house prices.** Mortgage rates in advanced countries continued to rise in the wake of tighter monetary policy, from 2.9% to 4.1% between December 2022 and November 2023 in the euro area and to around 6.8% in the US in December 2023, leading to a decline in nominal house prices in some regions. In the third quarter of 2023, house prices in the euro area fell by 2.1% year-on-year. However, the picture varied between and within regions, reflecting differences in the degree of monetary policy tightening and housing market sensitivity to interest rate hikes. It is also important to note that although higher mortgage rates and reduced affordability hampered demand, supply-side constraints helped to keep house prices above pre-pandemic levels in several countries. In the wake of the Covid-19 pandemic and the subsequent increase in remote working, the commercial property

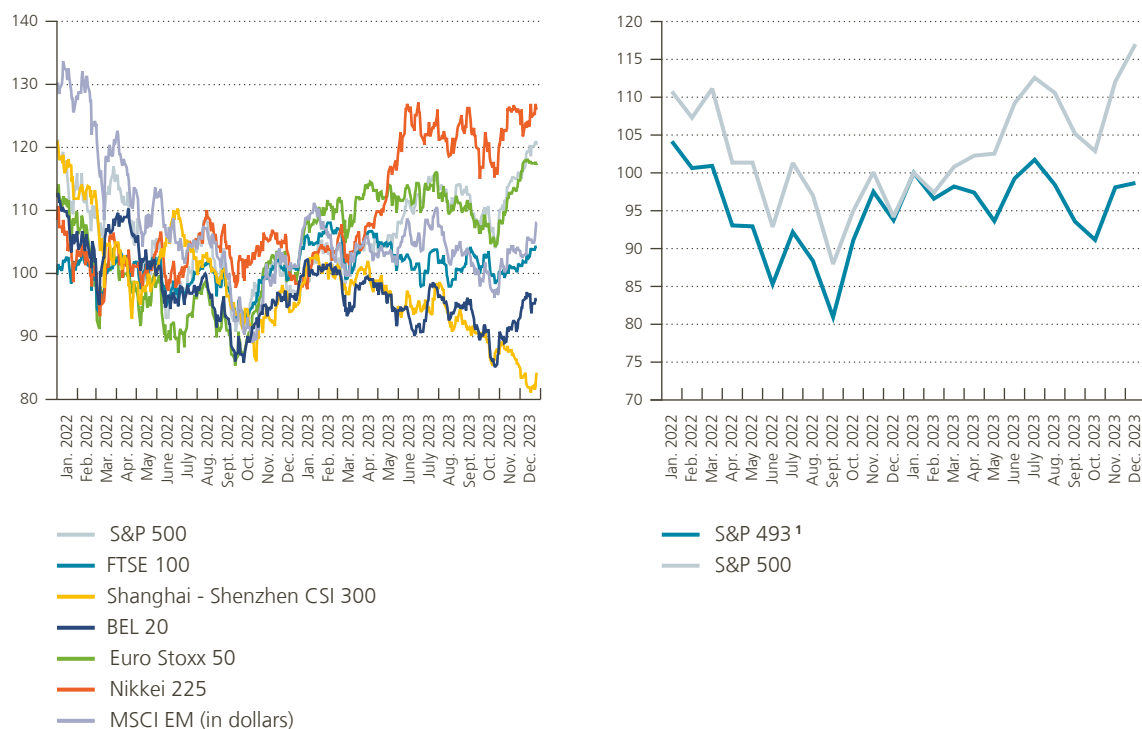
sector continued to face considerable challenges. Vulnerabilities in the commercial property sector are a major source of credit risk for the financial sector. At the beginning of 2023, transaction volumes in commercial real estate fell by 55% worldwide, year-on-year.

**Foreign exchange markets were marked by the persistent strength of the dollar and less volatility than in 2022.** The US dollar remained decidedly robust against almost all other currencies throughout the year. The currencies of several countries enjoyed a relative recovery following the tightening of monetary policy and the resulting narrowing of interest rate differentials. Thus, the euro and the pound sterling rebounded slightly. Nevertheless, the dollar remained strong, thanks not only to monetary policy but also to its safe-haven status in the face of escalating geopolitical tensions and armed conflicts. For its part, the Japanese yen continued to fall against the dollar.

Figure 1.6

**Equity markets in the euro area, Japan and the United States maintained their upward trajectory**

(price indices, January 2023 = 100)



Sources: Bloomberg, LSEG.

1 S&P 493: S&P 500 without the “Magnificent Seven” (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla).

**In the euro area, Japan and the United States, equity markets remained on the upward trajectory that had begun at the end of 2022.** This trend was the result of expectations that central banks could soon begin easing monetary policy. Equity valuations returned to their pre-pandemic levels. The performance of technology stocks (the “Magnificent Seven”), fuelled by the boom in artificial intelligence, continued to drive up stock markets, particularly in the United States. In Japan, equities performed better than in other advanced economies. Emerging markets such as Chile, India and Mexico also saw significant increases in share prices. Investor optimism about the economic outlook helped to dampen market volatility, particularly on the US stock markets.

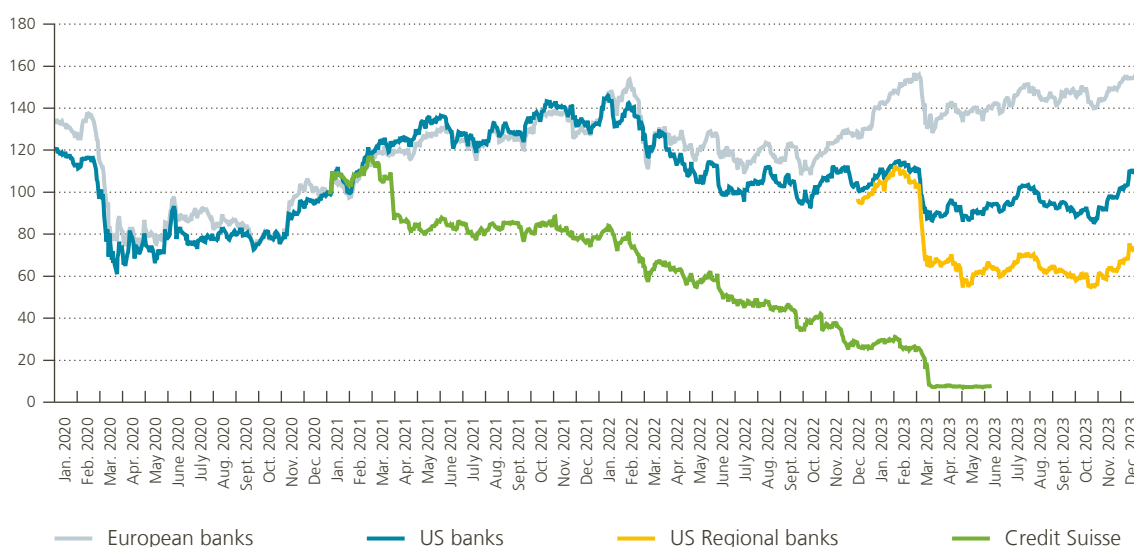
**Despite the turbulence observed in March following bank failures in the US and Switzerland, bank share prices proved resilient.** In March 2023, bank share prices in the US and Europe came under pressure following bank failures in the US (Silicon Valley Bank, Silvergate Bank and Signature Bank) and Switzerland (Credit Suisse), as well as more general concerns about the financial situation of US regional banks. More particularly, the problems at Silicon Valley

Bank (SVB) highlighted the risks associated with interest rate management and asset concentration. During the Covid-19 pandemic, SVB saw a significant increase in deposits, primarily from technology companies and start-ups. These funds were subsequently invested in long-term bonds. However, as interest rates rose, the value of these bonds plummeted, resulting in considerable financial losses for the bank. With its technology customers experiencing financial difficulties, SVB was affected by massive withdrawals of funds which forced it to sell off its bond holdings at a loss, raising concerns as to its financial health. Faced with the bank’s worsening financial situation and fears of a systemic banking crisis, US regulators stepped in and took control of the bank in March 2023. In addition, in order to mitigate the risk of contagion in the United States banking system, the authorities intervened to cover all deposits at Silicon Valley Bank and at Signature Bank, which had failed shortly after, and to introduce a new liquidity programme, particularly for regional banks such as First Republic Bank. Despite this intervention, market sentiment remained fragile, leading the regulator to take over First Republic Bank at the end of April, with the bank subsequently being sold to JP Morgan. In Europe, following a loss of

Figure 1.7

**Despite the turbulence seen in March in the United States and Switzerland, bank share prices proved resilient**

(price indices, 1 January 2021 = 100)



Source: LSEG.

confidence as a result of a number of scandals and poor risk management, Credit Suisse initially tried to bolster its liquidity by borrowing heavily from the Swiss central bank. However, these measures were insufficient, leading to its subsequent acquisition by a rival, UBS, to stave off bankruptcy.

**Several factors softened the impact of this turbulence on banks in the euro area and the United States.** Firstly, investors recognised that institution-specific rather than generalised vulnerabilities were at the root of the problems experienced by these US and Swiss banks. Secondly, significant differences in certain aspects of the respective regulatory and supervisory frameworks of the jurisdictions concerned were also identified. Overall, the banking sector has demonstrated its resilience since the pandemic, having faced trying conditions marked by economic uncertainty, high inflation, rising interest rates and a crisis of confidence in the spring of 2023.

## 1.3 Government deficits remained at high levels in the major economies

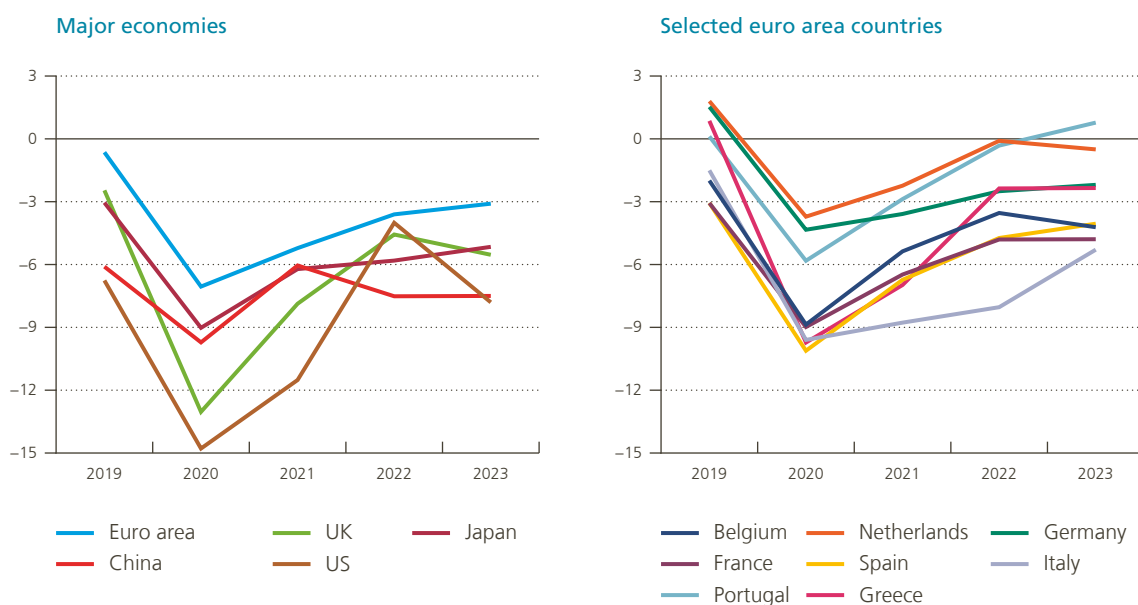
**Fiscal policy varied across the major economies but didn't help to curb inflation in most countries.** After swelling considerably in 2020 as a result of the Covid-19 pandemic, public deficits in certain advanced countries continued to shrink in 2023, after having begun to do so from 2021 onwards. In 2021, this improvement was due to the mechanical effect of the economic recovery. In addition, pandemic-related support measures could already be partially or fully relaxed, depending on the sector

concerned. By 2022, in most economies, GDP was continuing to grow and any remaining Covid-19-related measures could be lifted. However, deficit reduction in net energy importers, such as the EU and Japan, was limited by measures introduced to contain the effects of rising inflation on households and businesses. By 2023, these measures were of a sufficiently smaller scale, helping to narrow general government deficits further in these economies. In most cases, this more than offset increases in

Figure 1.8

The US deficit is the only one that increased significantly in 2023

(percentage of GDP)



Sources: EC (autumn) for euro area countries; Eurosystem (December) for the euro area as a whole; IMF (2023 Article IV report) for China; NAI-NBB for Belgium; OECD (December) for other advanced economies.

interest expenses as well as, in the EU, a less buoyant business climate that has been putting a strain on corporate revenue. In other advanced countries, such as the United States, fiscal policy was expansionary and public deficits deteriorated once again. In the major economies, deficit levels were still higher than in 2019.

**In general, and in the euro area in particular, government deficits shifted less in 2023 than in the years since 2019.** General government budget balances improved in less than half of euro area countries, which now number twenty since Croatia joined on 1 January 2023. Among the larger economies, borrowing requirements fell in Germany, Italy and Spain, but stagnated in France. Italy's deficit, for example, was less impacted by government subsidies to households for home renovations. In the other euro area economies, including Belgium, a rise in current primary expenditure and higher interest expenses

contributed to a widening of deficits, as described in chapter 8. Overall, public investment increased as a result of the Recovery and Resilience Facility and cohesion policy funding.

**In 2023, eight European Union countries, including Italy, France, Belgium and Spain, were yet to bring their deficits below the reference value of 3% of GDP enshrined in the protocol to the Maastricht Treaty.** In 2019, most EU member states had a deficit below this level. In the spring of 2023, EU authorities decided that the general derogation applied since the start of the first wave of the Covid-19 pandemic would no longer be in force in 2024, meaning the Stability and Growth Pact rules would apply once again as from 2024. In December 2023, the Ecofin Council reached an agreement to substantially modify these rules. The revision of the European fiscal framework is the subject of a box in chapter 8.





**In both Japan and China, deficits shrank somewhat thanks to an increase in economic activity.**

In Japan, to help households cope with the energy crisis, subsidies for electricity, gas and oil were extended in an election year, while financial aid was granted to families with children. In the autumn, the extension of support measures went hand in hand with help for SMEs. In November, a new package of measures was introduced providing for, among other things, lower taxes on earned income and property, which however will not enter into force until 2024. In China, a more expansionary monetary policy stance was somewhat reinforced by fiscal policy. October saw the country's central government adopt a mid-year budget revision. The measures mainly consisted of financial aid for reconstruction work after summer flooding in the north of the country and investment to improve resilience to climate change. At the local level, public finances remained precarious.

**In the United States, restrictive monetary policy was accompanied by a large fiscal stimulus.** Several factors contributed to the substantial

widening of the US deficit: lower tax revenue, particularly on capital gains, increased spending on mandatory social programmes, higher interest expenses, higher military spending, and the costs of industrial policies (the Infrastructure Investment and Jobs Act and the Inflation Reduction Act).

**In the UK, fiscal policy was somewhat expansionary and the public deficit grew further.**

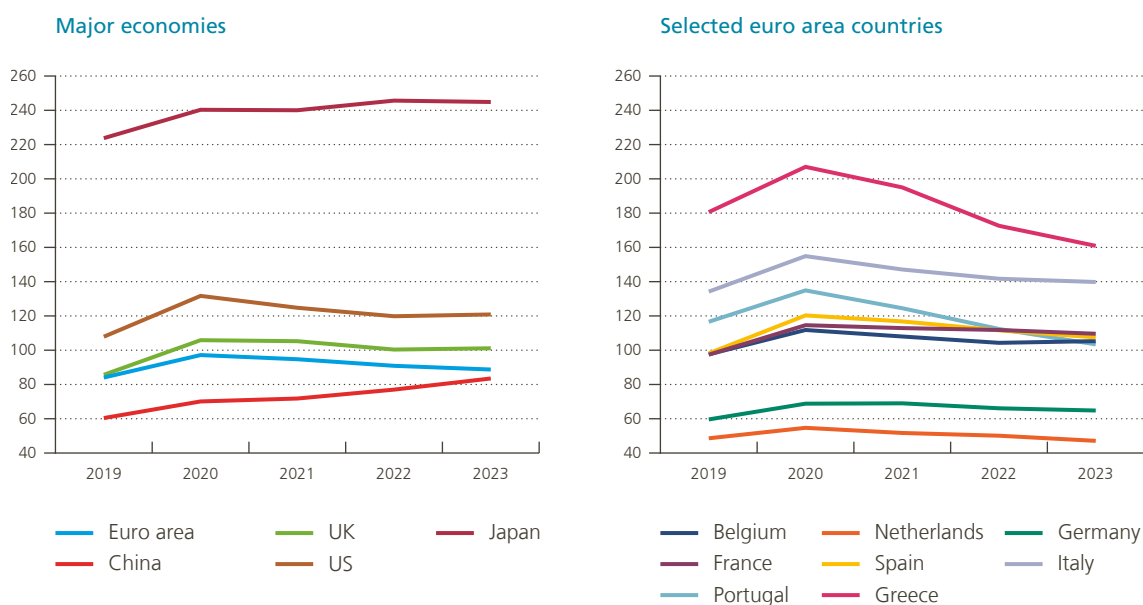
Income tax brackets were frozen by the government, while corporation tax was raised. In addition, the cap on energy prices was removed and other support measures were phased out or eliminated. However, military spending rose, national insurance contributions were cut, and businesses benefited from increased investment deductions. Moreover, a sharp slowdown in economic activity weighed on the general government budget balance.

**As was the case for government deficits, shifts in public debt were less pronounced in the major economies than in previous years.** Overall, nominal GDP fell in 2020, mechanically pushing up

Figure 1.9

**With few exceptions, public debt has fallen since 2020, but remains higher than before the pandemic**

(percentage of GDP)



Sources: EC (autumn) for euro area countries; Eurosystem (December) for the euro area as a whole; IMF (2023 Article IV report) for China; NAI-NBB for Belgium; OECD (December) for other advanced economies.

debt ratios. In 2021 and 2022, the denominator effect worked in the opposite direction to a large extent. In 2023, more modest changes in nominal GDP limited its impact. The rebound in interest rates also contributed to a snowball effect less favourable to the endogenous change in the debt ratio. The strength of economic growth in the US limited the increase in its debt ratio in 2023, despite the size of its deficit, which led Fitch to downgrade the country's credit rating in May and August. China is the only major economy whose debt rose substantially this year.

**Public debt fell in most euro area countries in 2023, with the notable exception of Belgium, yet generally remains above pre-pandemic levels and high by historical standards.** Mediterranean countries, whose particularly substantial debt levels had already dropped significantly since 2021, recorded the most notable reductions. In Portugal and Greece, public debt dropped below its pre-pandemic levels in 2023, and sovereign bonds benefited from rating upgrades.

## 1.4 Governments seek to support strategic sectors through industrial policy and protectionism

**In addition to fiscal policy in the strict sense, other economic policies were mobilised.** These include energy, environmental and industrial policies, with structural reforms also introduced in some countries – the latter notably carried out in the EU through the Recovery and Resilience Facility. Box 1 provides an overview of the increasing role played by industrial policy. More specifically, climate and energy policies have increased in importance given the more tangible manifestations of climate change (droughts, floods, extreme heat events etc.) and the fact that fossil fuels and certain raw materials critical to the energy transition are concentrated in countries with which relations have become strained or on which

excessive dependence could prove dangerous. The major economies, which are also the biggest polluters on the planet, are moving at different speeds towards the objectives of reducing greenhouse gas emissions and decarbonising the economy.<sup>1</sup> The EU demonstrated great ambition in this regard by adopting the European Climate Law in 2021, through which it aims to achieve net zero emissions by 2050. This ambitious target and its realisation are discussed in more detail in chapter 6.

<sup>1</sup> See De Sloover F., D. Essers and T. Stoerk (2023), “Do all roads lead to Paris? Climate change mitigation policies in the world’s largest greenhouse gas emitters”, NBB, *Economic Review*.



## The resurgence of industrial policy to achieve greater strategic autonomy, improve competitiveness and accelerate the green transition

**In recent years, there has been an intensification of geopolitical tensions and a reshuffling of the competitive balance between the world's various economic blocs.**

The continued technological and trade conflict between the United States and China, the Covid-19 pandemic, Russia's invasion of Ukraine and, more recently, the conflict in the Middle East have put international political and economic relations under severe strain. The rapid rise in energy prices affected the cost-competitiveness of European companies, particularly in energy-intensive sectors. Although gas and electricity prices in Europe have fallen significantly from their peaks in the summer of 2022, they remain well above those in the United States (see chapter 6). Competitiveness between economic blocs is also influenced by differences in productivity and the capacity for innovation. Although productivity growth has been slowing for some time in most advanced economies, it seems to be declining more sharply in Europe. This is believed to be the result of a combination of investment restraint and a relative slowdown in technological development, particularly in the electronics manufacturing and ICT services sectors. While Europe is performing well in sectors such as machine building, biotechnology, pharmaceuticals and new materials, it lags behind the US and Japan in terms of innovation in several strategically critical areas, including artificial intelligence, robotics and microelectronics. On these fronts, China is also gaining more and more ground.

**The necessary transition to a net-zero economy will also put European competitiveness to the test.** Internationally, there are still major differences in climate policy. The EU is currently the world's fourth largest emitter of greenhouse gases (responsible for just under 7 % of the global volume) and has the most ambitious climate change mitigation targets. The European policy approach is based primarily on carbon pricing, through the EU Emissions Trading Scheme, as well as regulations and standards for sectors falling outside the scheme. The European Climate Law provides a legal anchor for European climate objectives, which have also recently been confirmed or reinforced by judicial decisions in several countries (notably Belgium and Germany). Conversely, the current climate ambitions of China and India – the largest and third largest global greenhouse gas emitters (29 % and 7 %), respectively – are incompatible with the Paris Agreement objective of limiting the rise in average global temperature to well below 2°C. However, China's hegemony over green value chains, from the production of solar panels to batteries and electric cars, and its impressive deployment of renewables should enable a more rapid reduction in Chinese emissions. The United States remains the second biggest emitter of greenhouse gases (11 %) and has recently made welcome progress in terms of climate ambition and policy. However, the country has refrained from setting a federal carbon price and relies mainly on subsidies to stimulate investment in clean energy and related supply chains, with the result that it is still not meeting its climate targets under the Paris Agreement. Such differences in ambition and policy risk putting Europe at a competitive disadvantage. The European Carbon Border Adjustment Mechanism (CBAM), which will be introduced gradually, protects European producers of emission-intensive components (cement, iron and steel, aluminium, fertilisers, electricity and hydrogen) from



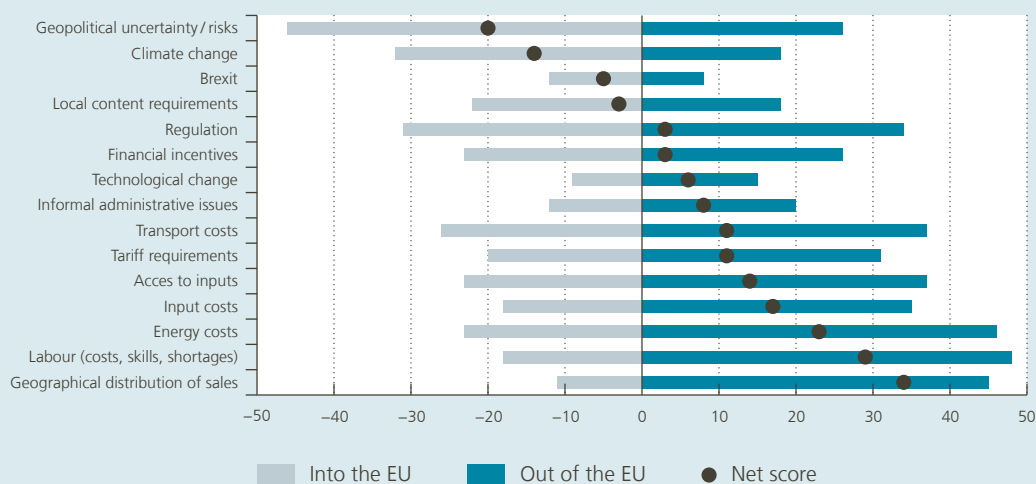
competing imports from regions with less stringent emission rules. However, unlike the allocation of free allowances, which is being phased out, the CBAM does not involve support for European exports of emission-intensive products, a choice that was made to ensure the mechanism's compatibility with World Trade Organisation (WTO) rules.

**Where companies decide to produce and the sourcing strategies they adopt are determined by the availability and cost of inputs, as well as by geopolitical risks.** To date, aggregate trade statistics at EU level have not yet revealed clear patterns of fragmentation along geopolitical lines. Influenced by bilateral tariff measures, however, China's share of US imports has fallen significantly since 2018. Still, the countries that have taken China's place, in particular Mexico and Vietnam, are largely integrated into Chinese supply chains, meaning a real decoupling between the US and China does not yet seem to be taking shape. Making significant adjustments to corporate supply chains is a lengthy process, however, and it may take a long time for these adjustments to become visible. Several recent surveys of European firms point to their greater willingness to relocate production in the near future. Among a group of large firms surveyed by the ECB, those planning to relocate production outside the EU outnumber those planning to do the opposite. Multinational companies relocating production outside the EU, or planning to do so, are mainly driven by energy costs, the cost and availability of certain worker profiles and other inputs, as well as shifts in the geographical distribution of sales. Conversely, geopolitical risks are cited as an important determinant in companies' decisions to (re)locate more production to the EU. As far as sourcing strategies are concerned, firms are planning to further diversify their supplier network and/or to engage in more "nearshoring" or "friendshoring" in the years ahead.



## Differences in the cost of energy and other inputs help determine the relative attractiveness of economic regions

Importance of different factors taken into account when moving business operations into or out of the EU<sup>1</sup>  
(percentage of responses)



Source: ECB.

<sup>1</sup> Responses from 62 leading companies operating in the euro area to the question “Which of the following factors do you consider particularly important in relation to recent or planned future moves of production/operations into or out of the EU?”. See Attinasi M.G., D. Ioannu, L. Lebastard and R. Morris (2023), “Global production and supply chain risks: evidence from a survey of large firms”, ECB, *Economic Bulletin*, 7/2023, 33-41.

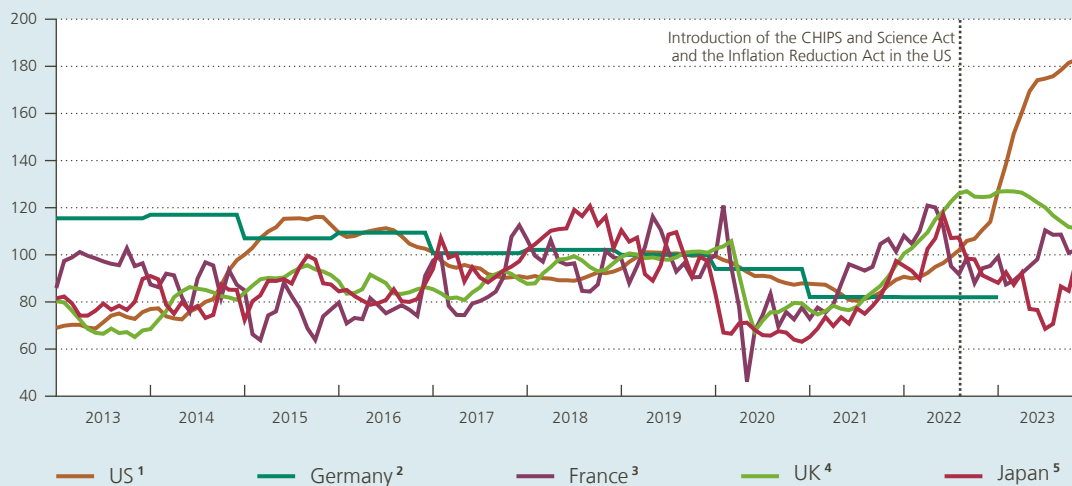
**Advanced countries, particularly the United States, are increasingly turning to “industrial policy”, i.e. targeted public support aimed at stimulating strategic sectors.** The world’s various economic blocs are each trying to strengthen their competitiveness and resilience. Industrial policy, through which governments support specific sectors – notably by means of subsidies, tax breaks, concessional lending, state guarantees and equity stakes – is no longer taboo in this respect. Today, the focus is mainly on sectors deemed strategic based on considerations of national security, security of supply, and/or the climate transition. In the US, industrial policy is seen as necessary to achieve greater autonomy from China and to protect existing jobs or create new ones in the manufacturing sector. The two main US policy packages are the CHIPS and Science Act, intended to support the semiconductor industry, and the Inflation Reduction Act (IRA), the centrepiece of US climate policy, both of which entered into force in August 2022. In particular, the IRA provides tax credits for investment in clean energy and for clean energy production (and related technologies), as well as for the purchase of electric and hybrid vehicles. Various support measures in the IRA are linked to requirements in terms of locally produced value added.

**Europe, too, has begun to roll out its industrial policy, largely inspired by that of the United States.** Europe’s response to the CHIPS and Science Act and the IRA includes, respectively,



## Supportive industrial policies have contributed to an exceptional increase in the construction of production facilities in the United States

(manufacturing construction, 2019 indices = 100, three-month moving average)



Sources: US Bureau of Labour Statistics, Destatis, INSEE, Japanese Ministry of Land, Infrastructure, Transport and Tourism, UK Office of National Statistics, US Treasury, US Census Bureau.

1 Value of private construction works in the manufacturing industry, seasonally adjusted monthly figures, deflated by the producer price index for construction materials and components.

2 Number of newly completed factories and workshops, annual figures.

3 Floor space of newly started industrial premises, seasonally adjusted monthly figures.

4 Output of new private industrial construction, seasonally adjusted monthly figures, deflated by the producer price index for construction.

5 Floor space of newly started manufacturing buildings, seasonally adjusted monthly figures.

the European Chips Act, in force since September 2023, and the Green Deal Industrial Plan, parts of which have yet to be formally adopted. Like the United States, Europe is aiming for greater self-sufficiency. For example, the European Chips Act sets the objective of doubling the EU's share of global semiconductor production to 20% by 2030. The Net Zero Industry Act and the Critical Raw Materials Act, both part of the Green Deal Industrial Plan, contain similar targets for the local production of green technologies such as solar and wind energy, batteries, carbon capture and storage, as well as for the extraction, processing and recycling of the necessary critical raw materials.<sup>1</sup> A number of major European countries, including Germany, France and Italy, have drawn up their own industrial policy plans for the digital and green transitions. At present, the financial resources available from the EU budget to pursue industrial policies are limited. The Commission's plans to raise more common resources are encountering resistance from several Member States.

1 See Essers D. (2023), "The US Inflation Reduction Act and Europe's response", Belgian Financial Forum, *Revue bancaire et financière*.





**While industrial policy can help to remedy certain forms of market failure, it is not a silver bullet.** The debate on the effectiveness of industrial policy is far from settled. It remains very difficult to establish causal links, and the results appear to depend largely on the specific context in which the policy is pursued. Industrial policy is generally justified by positive and/or negative externalities and coordination failures. Individual companies may well underinvest in innovations and technologies that would make an entire sector or the economy more competitive and less strategically dependent. Where it is politically impossible to put a fair price on greenhouse gas emissions, public subsidies or other incentives for the production and consumption of clean energy can make a difference. There is also a certain complementarity between these two approaches. The increased availability and affordability of green energy alternatives make higher carbon prices or stricter regulation more acceptable and also strengthen the response of emissions. The support provided by the CHIPS and Science Act and the IRA already seems to have given a major boost to the construction of new production facilities in the United States. The IRA is expected to significantly reduce the cost of solar, wind and other clean energy sources and to lower US emissions by around 10 percentage points compared to a scenario without the IRA. On the other hand, the IRA's subsidies, particularly as they are not capped, could absorb a large portion of the United States' fiscal space and have so far led to only limited job creation. Protectionist provisions such as local production requirements associated with US subsidies for the purchase of electric vehicles are contrary to WTO rules and risk provoking retaliatory measures from other blocs and countries, which would affect the speed and cost of the global climate transition. Another real risk is an international escalation of subsidies, fuelled by corporate lobbies and at taxpayer expense. Within the EU, a long-term relaxation of state aid rules for industrial policy may lead to economic fragmentation between Member States and undermine the single market.



**Geopolitical tensions and concerns about security of supply have also led to more protectionist trade policies.** After the global financial crisis, the era of trade liberalisation and WTO enlargement came to an end. Tensions between China and its trading partners, which accuse it of unfair trade practices, culminated in the Sino-American trade war during the Trump administration. The outbreak of the Covid-19 pandemic, which was accompanied by numerous (temporary) restrictions on the export of medical and pharmaceutical products, followed by Russia's invasion of Ukraine, to which Western countries reacted by imposing trade sanctions, in turn pushed up the number of new trade barriers implemented each year to unprecedented levels. At the same time, growing tensions between the superpowers, China and the United States, are increasingly affecting strategic sectors. For example, the United States has steadily tightened controls on exports to China of high-tech electronic chips used in artificial intelligence applications, as well as on the machines used to manufacture them. China has retaliated by restricting exports of raw materials essential to the

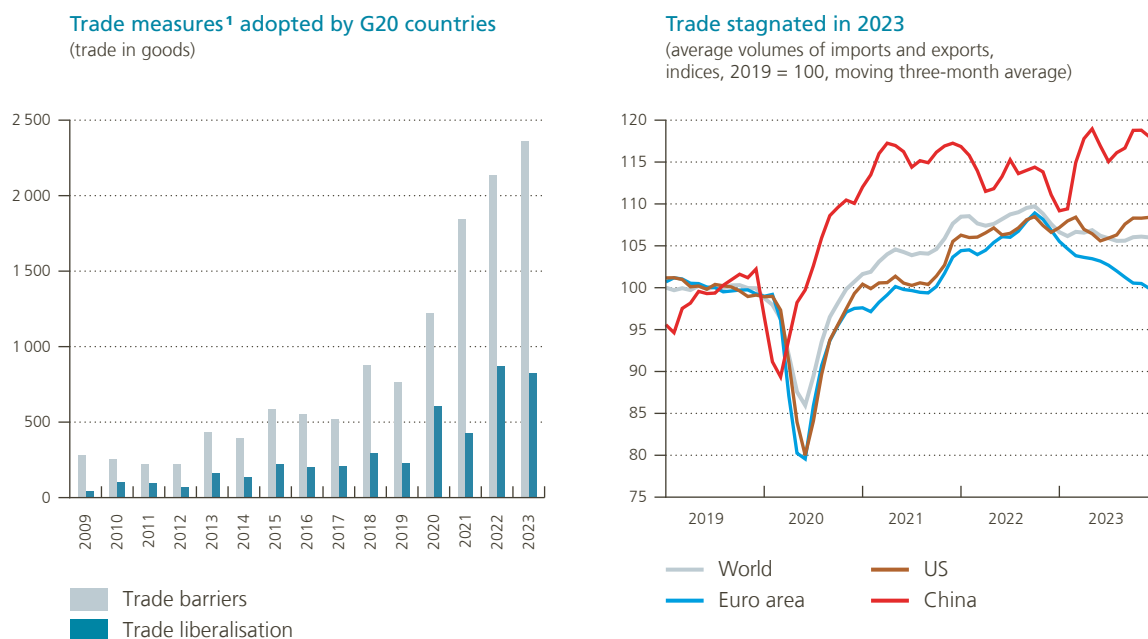
production of, among other things, chips and batteries for electric vehicles.

**The increase in protectionism is not yet clearly visible in total trade flows.** The trade war between the United States and China mainly led to a reorientation of trade, while many of the trade barriers imposed during the pandemic were temporary in nature. On the other hand, trade interventions prompted by geopolitical tensions and rivalries between the major powers, which most often target high-tech goods and critical raw materials, are a new phenomenon. Their impact on trade is therefore not yet clear. However, the EU's high degree of openness makes it vulnerable to these protectionist measures, with particular regard to export quotas for goods for which there are no other suppliers and which are essential to the green and digital transitions.

**The weakening of trade in 2023, apparent mainly in the euro area, reflects above all the slow-down in industrial activity worldwide.** When

Figure 1.10

**Rising trade barriers are (for the moment) not leading to deglobalisation**



Sources: Central Planning Bureau (the Netherlands), Global Trade Alert, LSEG.

1 New trade barriers adopted during the course of a year and made public before the end of that same year.

economies were partially reopening in 2021, trade was unexpectedly supported by a strong increase in demand for consumer durables, particularly in the United States. In 2023, a reverse shift took place in favour of the consumption of services, while purchases of consumer durables lagged behind. Faced with weak demand for goods, companies reduced their inventories. The rise in interest rates also weighed on more interest rate-sensitive sectors, such as capital goods and construction, which are also highly trade-intensive. The rise in the cost of trade credit also contributed to the decline in trade. However, the proliferation of new trade barriers, as mentioned above, could possibly, in the long term, further constrict trend growth in trade.

## 1.5 Although the global economy has not yet fully recovered from successive shocks, growth held up better than expected in 2023

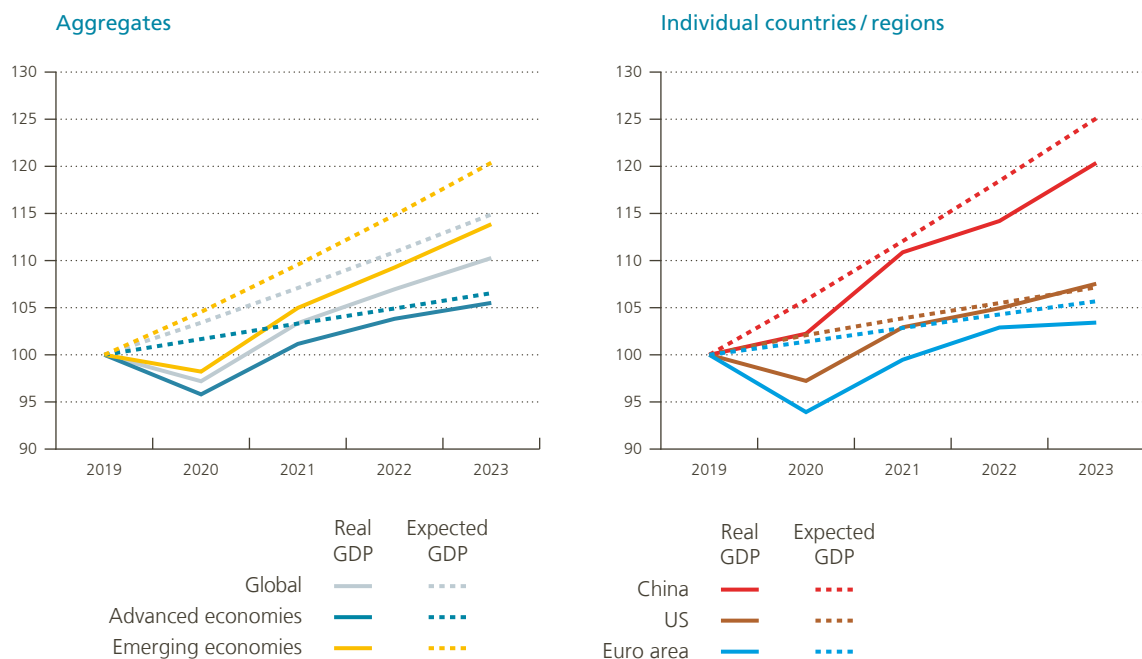
**The economic recovery following the Covid-19 pandemic and Russia's invasion of Ukraine is incomplete almost everywhere.** Had the projections made in the autumn of 2019 materialised, global GDP would currently be 5% higher. The loss is greater for emerging market and developing economies than for advanced economies. The former had less fiscal space to support their economies during

the pandemic, while their economic fabric was vulnerable to the onslaught of the virus. They also reopened later than advanced economies. These factors slowed the recovery of consumption in these countries, which was further thwarted by subsequent shocks, including the rise in food and energy prices, which account for a larger share of consumption in emerging market and developing economies,

Figure 1.11

**GDP growth was less favourable than expected prior to the outbreak of the pandemic**

(indices, 2019 = 100)



Source: IMF.

following Russia's invasion of Ukraine, as well as an increase in financing costs due to the tightening of US monetary policy from 2022 onwards. Finally, the marked deceleration in Chinese growth in 2022 also adversely affected the expansion of other emerging market economies. As a result, the rate of convergence of GDP per capita between emerging market and advanced economies slowed.

**The US was the only major economy to recover fully from both shocks.** The US economy benefited from, among other things, a large stimulus during the pandemic and a positive terms-of-trade shock following Russia's invasion of Ukraine. In the euro area, on the other hand, high dependence on energy imports (from Russia) led to a negative terms-of-trade shock in 2022. At first, China also seemed well placed to make up the losses caused by the pandemic and, like the US, was not very exposed to the fallout from Russia's war in Ukraine. However, its strict zero-Covid policy and recent property market troubles have hampered its recovery.

**After rebounding more strongly than expected in the first half of the year, the global economy gradually lost momentum towards the end of 2023.** In the first few months of the year, global economic activity was shored up by the reopening of the Chinese economy, the normalisation of supply chains, and fairly resilient consumer spending characterised by a further uptick in demand for services. The problems encountered by Swiss and US banks were quickly brought under control, without any significant impact on the real economy. However, the global economy had to contend with powerful headwinds in the final quarter of the year, such as tighter financial conditions, which curbed investment, sluggish international trade, and renewed geopolitical uncertainty caused by the conflict in the Middle East. Overall, the world economy grew by 3.1% in 2023, exceeding the forecasts made at the start of the year. This is, nevertheless, a substantial slowdown compared to the 3.5% recorded in 2022 and, above all, compared to the average growth rate of 3.8% over the 2000-2019 period.

Table 1.1

### GDP of the major economies

(annual rate of change)

|   | 2021       | 2022       | 2023       | <i>p.m.</i><br>Average<br>growth<br>2000-2019 | <i>p.m.</i><br>Contribution to<br>world growth<br>2023 | <i>p.m.</i><br>Share of<br>world GDP <sup>1</sup><br>2022 |
|---|------------|------------|------------|---|--|---|
| Advanced economies                          | 5.6        | 2.6        | 1.6        | 1.9   | 0.7  | 41.7  |
| of which:                                   |            |            |            |   |  |   |
| United States                               | 5.8        | 1.9        | 2.5        | 2.1   | 0.4  | 15.4  |
| Japan                                       | 2.2        | 1.0        | 1.9        | 0.8   | 0.1  | 3.7   |
| Euro area                                   | 5.9        | 3.4        | 0.6        | 1.4   | 0.1  | 12.0  |
| United Kingdom                              | 8.7        | 4.3        | 0.5        | 1.8   | 0.0  | 2.2   |
| Emerging market and<br>developing economies | 6.9        | 4.1        | 4.1        | 5.5   | 2.4  | 58.3  |
| of which:                                   |            |            |            |   |  |   |
| China                                       | 8.4        | 3.0        | 5.2        | 9.0   | 1.0  | 18.8  |
| India <sup>2</sup>                          | 9.1        | 7.2        | 6.7        | 6.9   | 0.5  | 7.5   |
| Russia                                      | 5.6        | -1.2       | 3.0        | 3.7   | 0.1  | 2.3   |
| Brazil                                      | 5.3        | 3.0        | 3.1        | 2.4   | 0.1  | 2.9   |
| <b>World</b>                                | <b>6.3</b> | <b>3.5</b> | <b>3.1</b> | <b>3.8</b>                                    | <b>3.1</b>   | <b>100.0</b>  |
| <i>p.m.</i> World trade                     | 10.9       | 5.2        | 0.4        | 4.9   |  |   |

Sources: ECB, IMF

1 As defined by the IMF and calculated on the basis of purchasing power parities (2017 version).

2 For India, the growth figures cover the financial year, which begins in the second quarter of the current year.

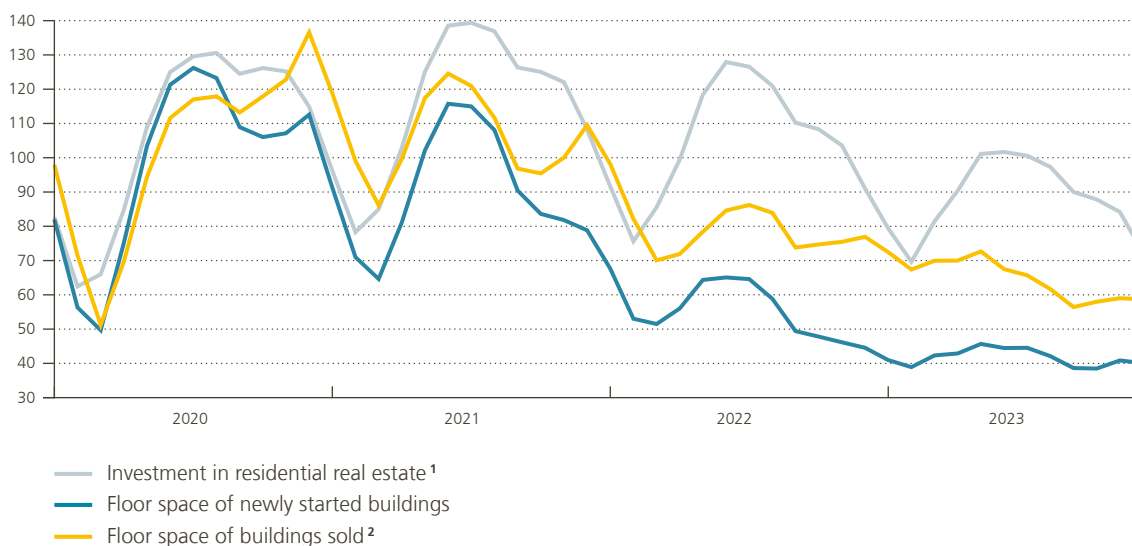
**Emerging market and developing economies showed stable growth compared with the previous year.** They were the engines of the world economy, contributing just over 75 % of global growth. Emerging Asian economies, in particular, posted solid growth. As Covid-19 containment measures were maintained for longer in this region, the economic recovery from the pandemic began later than elsewhere. As a result of this lag in the economic cycle, demand was less of a trigger for inflation in these countries, so that a more modest tightening of monetary policy was sufficient to maintain price stability. The continued normalisation of international tourism in Asia and strong demand for services in general also lent support in several countries, including India. Conversely, many economies in South America, the Middle East and North Africa lost steam under the effect of much tighter monetary policy and the fall in commodity prices caused by the collapse in global industrial production. Finally, extreme weather events caused considerable economic damage in parts of India and China, among other countries.

**China’s economic recovery was less robust than expected.** At the end of 2022, China announced the end of its zero-Covid policy, thereby igniting lofty expectations. The euphoria lasted only a few months, however, before well-known structural weaknesses, notably heavy reliance on debt-financed investment in property and infrastructure, resurfaced. In the summer of 2023, Country Garden, a private property company with a good reputation, reported financial difficulties. Confidence in the sector deteriorated again, dragging down sales and rendering companies ever more reluctant to launch new housing projects. Despite new government measures, the property market has not yet regained full stability. On top of this, consumer confidence remains at a low ebb, with households favouring precautionary savings over consumption. Consumption did grow by 5 %-6 % but given the modest weight of private consumption in the Chinese economy, this was not sufficient to offset the fall in housing investment. Given its specialisation in the production of electronic goods and other

Figure 1.12

**China’s residential construction sector weakened further**

(indices, 2019 = 100, moving three-month average)



Source: CEIC.

1 Investments expressed by value (renminbis).

2 90 % of sales on the property market involve the off-plan purchase of a new home.



consumer durables for export, China has also had to contend with sluggish foreign demand and trade in these goods.

**The resilience of the US economy came as a surprise, while most advanced economies made a soft landing.** In the US, consumption and investment held up better than expected. A tight labour market with rising employment, healthier household financial balances, a high proportion of (mortgage) loans with (low) fixed interest rates, high house prices and strong equity markets offset the tightening of monetary policy and sustained consumption. New investment in industry, including in clean energy and semiconductors, picked up strongly, encouraged by the CHIPS and Science Act and the Inflation Reduction Act (see Box 1). The overall fiscal policy stance also remained very accommodative. By contrast, these factors had little or no influence in the euro area and the UK.

**After starting the year well, the Japanese economy ran out of steam in the second half, while the British economy remained sluggish throughout the year.** In the first quarter, domestic demand shored up Japanese growth, but accelerating inflation and rising uncertainty then caused private consumption and investment to fall back. The slowdown in domestic demand weighed on imports, while car exports rose, enabling net exports to return a positive balance. Although the UK avoided a recession, its economy remained sluggish, due to more persistent inflation, high financing costs and a gradual slowdown in the labour market, which weighed on domestic demand, as well as a continuing trade deficit.

**At the euro area level, most drivers of demand had receded by 2023, above all consumption – both private and public – but also exports.** ECB studies<sup>1</sup> have shown that households in the euro area largely held on to the excess savings they had accumulated during the pandemic (due to purchases being rendered impossible by partial or general business closures or fear of contamination or to precautionary saving). Business and consumer confidence indicators show that their behaviour was influenced by the climate of great uncertainty. Consumption was also curbed by tighter financing conditions and falling real wages. Rising interest rates and the need for governments to reduce deficits in a context of

<sup>1</sup> See in particular Battistini N. and J. Gareis (2023), *Excess savings: To spend or not to spend*, ECB blog, 2 November.

high indebtedness weighed on public consumption in the euro area. Consumption was the main difference between the United States and the euro area in 2023. Investment was somewhat more resilient, thanks in particular to the implementation of recovery plans. However, housing investment, and hence construction activity, was affected by the abrupt rise in the cost of credit and by labour shortages. Growth in the euro area was also modestly boosted by net exports in 2023, but this was mainly due to a fall in imports: exports virtually stagnated, against a backdrop of sluggish foreign demand. The negative impact of the energy price shock on production costs also affected the competitiveness of European industry, leading to a loss of external market share in 2023. According to recent surveys of business leaders conducted by the European Commission, respondents believe that their firms' competitiveness on foreign markets is deteriorating. The EC has asked Mario Draghi to conduct a more in-depth study of the EU's competitiveness, particularly in relation to the United States and China, the results of which are forthcoming.

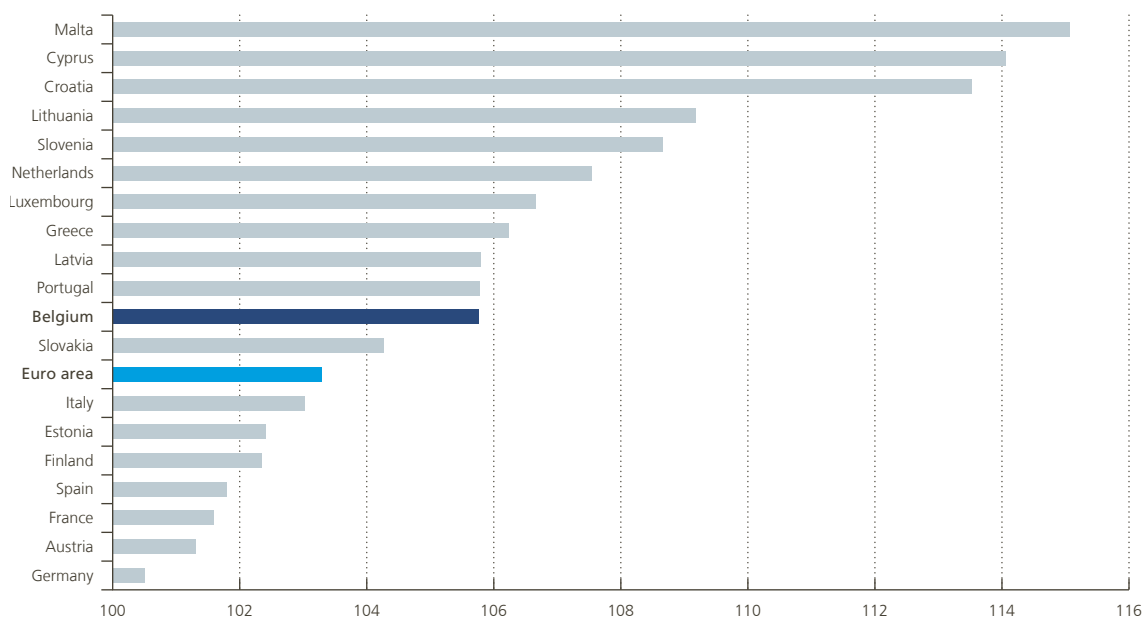
**The slowdown in economic growth in the euro area in 2023 is delaying the prospect of returning to the pre-Covid-19 trend.** Thanks to the mechanical effects of the resumption of activities that had been halted or interrupted during the successive waves of the pandemic and to the highly expansionary policies adopted in response, GDP in the euro area rebounded in 2021 and 2022. By 2022, the drop seen in 2020 was all but erased and it looked like this upward trend was set to continue. However, the rise in energy prices, the impact of which spread across the region's economies and was amplified by Russia's invasion of Ukraine, put the brakes on activity in the euro area. Industry, especially energy-intensive sectors, bore the brunt. Services were more resilient, but also saw their activity eventually slow. In 2023, the slowdown affected every country in the European monetary union, with GDP even falling in Germany, Austria, Luxembourg, Ireland, Finland and the three Baltic States.

**Germany posted the lowest GDP growth in the euro area since 2019.** Firstly, this large, very open

Figure 1.13

**Since 2019, real GDP has virtually stagnated in Germany, while it has grown more briskly in many smaller euro area countries<sup>1</sup>**

(cumulative change between 2019 and 2023; index, 2019 = 100)



Source: ECB.

<sup>1</sup> Ireland is not included here for reasons of readability. Its real GDP rose by more than 30% between 2019 and 2023 due to the operations of certain large multinationals.

and export-oriented economy suffered greatly from the logistical bottlenecks and supply chain problems that arose in 2020 and 2021. Secondly, energy-intensive industry, which plays an important role in the country's economy, suffered from soaring energy prices in 2022. Thirdly, the German economy was also more exposed to the slowdown of growth in China, of which it is a very important trading partner, and to the general weakening of world trade in 2023. Having been slow to switch to the production of electric vehicles, the German automotive industry currently remains highly dependent on inputs from China, particularly batteries. Finally, Germany also lags behind in terms of investment in infrastructure and digitalisation.

**The French economy was not an outstanding performer during this period either.** France has yet to fully recover from the dive that its exports took in 2020, registering the largest decline in the euro area after Spain and Greece, both of which rely strongly on tourism. Aside from the temporary collapse of its export markets, France also lost market share. In 2022, the shutdown of several nuclear reactors reduced energy production and forced France to

become a net importer of electricity, further deteriorating its trade balance. As discussed in Box 4 (chapter 4), public consumption and housing investment also contributed to France's failure to return to its pre-crisis growth path.

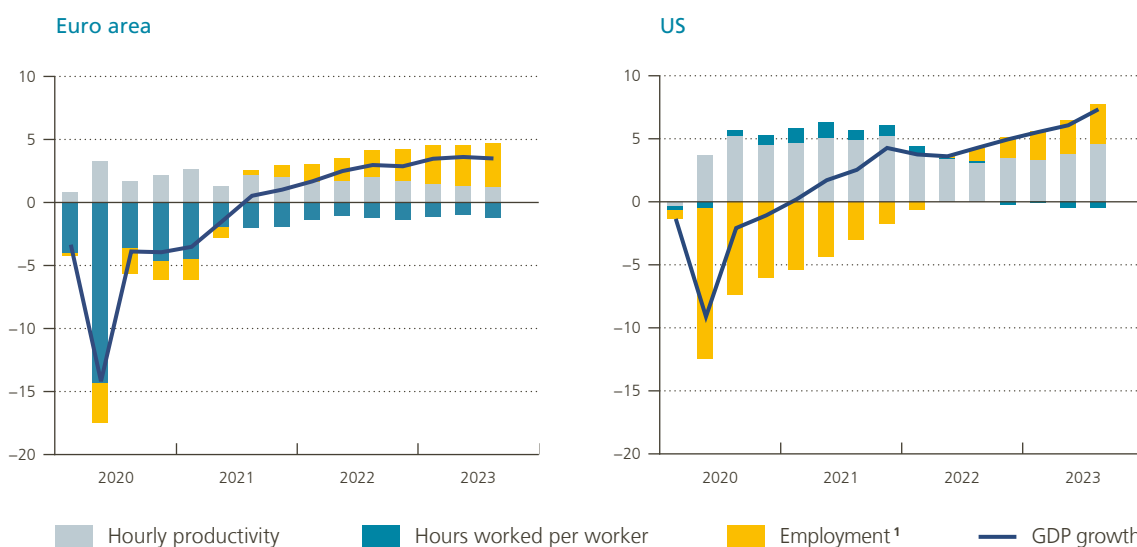
**Countries more strongly affected by the pandemic, such as Italy and Spain, were able to benefit from European funds to finance their recovery.** To do so, they had to put in place milestones for structural reforms aimed at boosting their potential long-term growth. In 2022 and 2023, tourists also returned *en masse* to these two countries. Overall, however, their GDP grew less quickly than that of the euro area as a whole. In contrast, smaller countries, including Belgium, fared better.

**Generally speaking, post-pandemic growth in the euro area turned out to be employment-intensive, with labour market resilience a significant explanatory factor for the higher growth observed in 2023 than forecast at the start of the year.** Indeed, at the height of the pandemic, furlough schemes enabled companies to lay off fewer staff. With the strong post-Covid-19 recovery,

Figure 1.14

**The recovery was supported by a rise in employment**

(cumulative percentage change since Q4 2019)



Sources: ECB, US Bureau of Economic Affairs, US Bureau of Labor Statistics, LSEG.

1 Employment in persons.



labour shortages intensified in a growing number of sectors. This also encouraged companies to retain existing staff despite the recent slowdown in activity. In the US, employers resorted to more large-scale redundancies during the pandemic and only recently began recruiting substantially. Labour markets in the US and the euro area remained tight throughout the year, but the latest figures suggest that a turning point may have been reached in both economies.

**Conversely, the economic recovery has been characterised, particularly in the euro area, by weak gains in labour productivity, measured by output per hour.** The latter has even fallen in recent quarters in the euro area. As indicated in Box 1, a number of structural factors may explain the

weakness in productivity trend growth in the euro area. Another explanation could be labour hoarding, which has been more pronounced in the euro area. Industry, the economic importance of which is greater in the euro area than in the United States, has seen output shrink in recent years, caused by disruptions in international supply chains in 2021 and 2022, the energy crisis in 2022 (which mainly affected energy-intensive sectors in Europe), and, in 2023, the slowdown in global industrial output resulting from weak demand. Yet industrial firms have been reluctant to lay off workers for fear of facing recruitment problems down the road in a tight labour market, exacerbated by population ageing. As a result, labour productivity in industry has fallen. New jobs were mainly created in services sectors, which are generally less productive.



